No. 2950

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

JOSEPH J. SCOTT, as Collector of Internal Revenue of the United States for the First Collection District of California,

Appellant,

vs.

WESTERN PACIFIC RAILROAD COMPANY; and FRANK G. DRUM and WARREN OLNEY, JR., Receivers of the Property of the WESTERN PACIFIC RAILWAY COMPANY,

Appellees.

BRIEF OF APPELLANT

Upon Appeal from the Southern Division of the United States District Court for the Northern District of California, Second Division.

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Attorneys for Appellant.

Filed this ..... day of ....., 1917.

FRANK D. MONCKTON, Clerk,

By ....., Deputy Clerk.

NEAL PUBLISHING CO., PRINT., SAN FRANCISCO.

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BRIEF FOR APPELLANT

I.

STATEMENT OF THE CASE.

This is an appeal from a final order made and entered the 21st day of August, 1916, in the case of The Equitable Trust Company of New York as Trustee, complainant, vs. Western Pacific Railway Company, et al., defendants, relative to the Rulings

of the Court, as to whether the funds in the hands of the Receivers of the Western Pacific Railway Company, represented by the net proceeds in conducting the operations of the road are subject to tax under the Federal Income Tax Act.

The Receivers of the Western Pacific Railway Company filed a return of its net income for 1915 in accordance with the Income Tax Law, Act of October 3, 1913, which return showed no taxable income. It appeared to the Treasury Department that certain deductions from the gross income received were not actually paid and said deductions were disallowed, and the Company was assessed an income tax of $14,080.35 (Trans. pp. 12-13).

A petition was filed by the Receivers of the said Company in the above entitled cause asking for Rulings in regard to the said assessment, making Joseph J. Scott, Collector of Internal Revenue of the United States, for the First Collection District of California, defendant, (hereinafter designated appellant) (Trans. p. 10).

The appellant moved to dismiss Petition for Rulings in Regard to the Income Tax, upon the ground that the Court had no jurisdiction or authority to substitute its judgment or discretion for that of the official entrusted by law with its execution; That the Court had no right to set aside a ruling made by an officer of the executive department in pursuance of authority delegated by Congress; That their

remedy was an appeal to the executive department having charge of the assessment and collection of the tax. (Trans. p. 15).

Upon hearing of the said motion, the Court was of the opinion that the funds in the hands of said Receivers were not subject to tax under the Federal Income Tax Act, nor were the said Receivers required to make a return of said earnings of the said Company, while in their hands as Receivers for the purpose of such tax, basing the opinion within the principles of *Penn. Steel Co.* vs. *N. Y. City Railway Co.,* 198 Fed. 775 (Trans. p. 3) and thereupon ordered that the Receivers be instructed that no payment of any income tax should be made (Trans. p. 4).

SPECIFICATIONS OF ERRORS.

II.

1. The Court erred in not dismissing the Petition for Ruling in regard to Income Tax.

2. The Court erred in assuming jurisdiction of the matter by substituting its judgment or discretion for that of the official entrusted by law with its execution.

3. The Court erred in taking jurisdiction of the matter, as to whether the funds in the receivers' hands were subject to the income tax, as Congress has provided a way in which taxpayers may ob-

tain relief from unjust assessment or from an illegal collection of taxes.

4. The Court erred in holding that the funds in the hands of the receivers, represented by the net proceeds in conducting the operations of the road while in their hands, over and above the expense and authorized expenditures paid out by them was not subject to tax under the Federal Income Tax Act as net earning of the corporation.

5. The Court erred in holding that the returns of the annual net income of the Western Pacific Railway Company for the year 1915, in the sum of $1,408,034.99 filed by the receivers of the company, were not subject to the Federal Income Tax Act.

6. The Court erred in holding and instructing the receivers that no payment of any income tax should be made.

ARGUMENT.

III.

There seem to be only two questions that arise in this case that are necessary for consideration. First: the question of jurisdiction; Second: whether income received during the taxing year from the property of a corporation held and operated during the entire year by its receivers, is subject to taxation under the Income Tax Act.

It would seem that the Court exceeded its jurisdiction when it entertained the right to substitute

its judgment for that of the Collector of Internal Revenue, by overruling his decision and instructing the receivers that no payment of any income tax should be made.

Section 3224 R. S. provides that

> "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court",

and Section 3226 R. S. provides that

> "No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive, or in any manner wrongfully collected, until an appeal shall have been duly made to the Commissioner of Internal Revenue, according to the provisions of the law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein."

If the receivers were dissatisfied with the assessment it was their duty under the law to appeal to the Executive department having charge of the assessment and collection of the tax, and if such decision was unfavorable to them, it was their duty to pay the tax and resort to their remedy in law;

> *Frost on Federal Corporation Tax Law,* Section 149,

Cheatham vs. *Norwell,* 92 U. S. p. 85 at p. 88,

Taylor vs. *Secor,* 92 U. S. p. 575 at p. 613.

The Court of Appeals of the District of Columbia, in the case of *Moore* vs. *Miller,* Vol. 5, of Appeal Cases, p. 428, said:

> "It is familiar law that courts of equity are always adverse to interfere with the collection of taxes; that they will never attempt to restrain the execution of tax law merely because of an illegality, hardship or irregularity of the tax complained of, and in the only instance that such court would interfere is where the party has no adequate remedy at law."

The Court further said that

> "It is apparent from an examination of the Act (referring to an Income Act) that many of the duties imposed by it upon the Commissioner of Internal Revenue, with respect to the tax on income, are of such a nature as involve the exercise of discretion by that officer in their performance. Among others is the decision of the manifold questions that most constantly arise as to the construction of points under the law, and the determination of appeals from collectors; which decisions are declared to be final, so far at least as the office is concerned. That discretionary duties of this character devolved on a public officer are not controlled by mandamus or by the writ of injunction, in some respects a correlative remedy, is common knowledge; and yet the present application would result in substituting the opinion of the court

as the guide of that official discretion, in case it did not go to the further extent of nullifying the entire provision as to the tax on incomes."

The Court, speaking on page 432 of the same case, said:

"The regulation of remedies rests entirely with the legislature, subject only to the limitation that some substantial mode of redress is left to the citizen. The Act of 1867 (Section 3224 R. S.) was evidently intended to prevent the ruinous consequences that might result to the credit or even the existence of the Government, if the courts everywhere on the application of different persons had full authority to restrain all proceedings under the laws to collect its revenues. The mischiefs to the whole country that might result are obvious to all; they are strongly set forth by Mr. Justice Field in *Davis* v. *United States,* 11 Wall. 113, and by Mr. Justice Miller in *Cheatham* vs. *United States,* 92 U. S. 89."

The Supreme Court said, speaking through Mr. Justice Miller, in the case referred to above, *Taylor* vs. *Secor*:

"The Government of the United States has provided, both in the Customs and in the Internal Revenue, a complete system of corrective justice in regard to all taxes imposed by the general government, which in both branches is founded upon the idea of appeals within the Executive departments. If the party aggrieved does not obtain satisfaction in this mode there

> are provisions for recovering the tax after it has been paid by suit against the collecting officer. But there is no place in this system for an application to a Court of Justice until after the money is paid."

In the case of *Louisiana* vs. *McAdoo,* 234 U. S. p. 634, where the Court had been asked to overrule the decision of the Secretary of Treasury, relative to the tariff rates on sugar, the Court said:

> "By statute originally enacted in 1792 (1 Stat. at L. 280, chap. 37), now Par. 249, Revised Statutes (U. S. Comp. Stat. 1901, p. 137), it is expressly provided that the Secretary of the Treasury is to 'superintend the collection of customs duties as he shall think best'. His interpretation of any custom law is made conclusive and binding upon all officers of customs, and upon his successors, until reversed by judicial decision. Rev. Stat. Par. 2652, U. S. Comp. Stat. 1901, p. 1821; act March 3, 1875 (18 Stat. at L. p. 469, chap. 136, Par. 2 U. S. Comp. Stat. 1901, p. 137). In the discharge of his duties, semijudicial in character, the Secretary of the Treasury is, by statute, entitled to the opinion of the Attorney General, which, as we may judicially know, was obtained in this matter. Opinion of the Attorney General, Feb. 14, 1914, Vol. 30, p.—.
>
> There is a class of cases which hold that if a public officer be required by law to do a particular thing, not involving the exercise of either judgment or discretion, he may be required to do that thing upon application of one

> having a distinct legal interest in the doing of the act. Such an act would be ministerial only. But if the matter in respect to which the action of the official is sought is one in which the exercise of either judgment or discretion is required, the courts will refuse to substitute their judgment or discretion for that of the official intrusted by law with its execution. Interference in such a case would be to interfere with the ordinary functions of government."

The next question is—are the funds in the hands of the receivers representing net earnings of the corporation subject to the income tax?

The record shows (Trans. pp. 11-12-13) that the receivers, in making their income tax return for the year ending December 31, 1915, deducted from the gross income $4,694,238.94 as interest due, when as a matter of fact, they only had $1,408,034.99 available to pay such amount and that the said available amount was in their hands at the time the assessment was made. The Collector of Internal Revenue held that no part of the interest was allowable, as allowable deductions must represent interest accrued and paid within the year for which the return is made. Such deductions must be confined to actual disbursements in cash, or its equivalent.

> Section B, lines 23-25 and Sec. G line 96 of the Federal Income Tax Law.

It was said by the Supreme Court in the case of *Cheatham* vs. *Norvekl*:

> "That all governments, in all times, have found it necessary to adopt stringent measures for the collection of taxes, and to be rigid in the enforcement of them."

Could it be conceived that Congress in enacting the Income Tax Act intended that millions of dollars in the hands of receivers of corporations, which in lots of cases are making big net earnings, should be shielded from such taxation?

It would be logical to assume that if the receivers in this case had paid the said amount that was available to its bondholders, the funds would not have escaped from taxation. If the theory is true that funds in the hands of the receivers are exonerated from the Income Tax, a creditor could well advise the debtor to delay payment for the purpose of defeating the tax.

His Honor, Judge Van Fleet, said in his opinion (Trans. p. 3):

> "I am of the opinion that the facts bring the case within the principles of *Pennsylvania Steel Company* vs. *New York City Railway Company,* 198 Fed. 775, and upon authority of that case it is held that such fund is not subject to the tax."

We do not think that this case is applicable to the present one, for the Pennsylvania Steel Company case was an interpretation of the Corporation Tax Act of 1909, in which the Court said it was a special

excise tax upon doing business in a corporate capacity; that individuals and partnerships were not subject to such a tax.

In that case the corporation had become insolvent, had lost its functions as a corporation by being placed in the hands of a receiver, and by losing its corporate capacity it was no longer obligated to pay such a privilege tax. This case, and others of like nature, was appealed to the Supreme Court, title of the case, *United States* vs. *Whitridge,* 231 U. S. p. 144.

The Court said that the tax was an excise or privilege tax and not in any sense a tax upon a property or upon income, merely as income; that the tax was imposed not upon the franchises of the corporation, irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate business.

IV.

CONCLUSION.

In view of the premises, we respectfully submit that the order herein should be reversed.

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